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Supreme Court, U.S.
FILED

MAR 3 2003

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No. 02-695

In The
Supreme Court of the United States

MICHAEL FITZGERALD, Treasurer, State of Iowa,

Petitioner,

v.

RACING ASSOCIATION OF CENTRAL IOWA, IOWA GREYHOUND ASSOCIATION, DUBUQUE RACING ASSOCIATION, LTD. and IOWA WEST RACING ASSOCIATION,

Respondents.

On Writ Of Certiorari To The Supreme Court Of Iowa

BRIEF FOR THE PETITIONER

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QUESTION PRESENTED

May the State of Iowa, without violating the Equal Protection Clause, tax the revenue from slot machines at racetracks at different rates than the revenue from all casino games, including slot machines, on riverboats?

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OPINION BELOW

The opinion of the Iowa Supreme Court is reported at *Racing Ass'n of Cent. Iowa v. Fitzgerald*, 648 N.W.2d 555 (Iowa 2002).

JURISDICTION

The decision of the Iowa Supreme Court was issued on June 12, 2002, and amended on September 6, 2002. A petition for rehearing was denied on August 6, 2002.

A petition for a writ of certiorari was filed on November 4, 2002, and granted on January 17, 2003.

Jurisdiction rests on 28 U.S.C. § 1257(a). There is no adequate and independent state law ground for the lower court decision. This Court will refuse to decide cases that rest on an adequate and independent state law ground due to "[r]espect for the independence of state courts" and the need to avoid "rendering advisory opinions." *Michigan v. Long*, 463 U.S. 1032, 1041-42 (1983). If state courts choose to rely on federal precedent in analyzing parallel state and federal constitutional provisions, so that the decision appears "to rest primarily on federal law, or to be interwoven with the federal law," this Court should accept jurisdiction in the absence of a "plain statement" that the federal precedent provides only guidance and does not compel the result. *Id.*

The Iowa Supreme Court did not make a "plain statement" to distinguish between the state and federal constitutional provisions in this case. Before it analyzed the tax statute at issue under the state and federal Equal Protection Clauses, the Court paused to "briefly address

the significance of invoking both the state and federal constitutions." (Cert. Pet. App. 6). After quoting the relevant text from each constitution, the Court observed that "Iowa courts are to 'apply the same analysis in considering the state equal protection claims as . . . in considering the federal equal protection claim.'" The Court indiscriminately cited both state and federal cases before it ultimately concluded that "the tax violates the state and federal equal protection clauses." (Cert. Pet. App. 16). At no time did the Court draw any distinction between the two constitutions. The state law determination was wholly dependent on and inseverable from the Court's understanding of the federal Equal Protection Clause.

The legal tradition in Iowa Courts is clear and well-established that the same analysis is used to resolve constitutional issues raised under the Equal Protection Clauses of the state constitution as is used to resolve such issues under the Equal Protection Clause of the Fourteenth Amendment. *See, e.g., Bowers v. Polk County Bd. of Supervisors*, 638 N.W.2d 682, 689 (Iowa 2002) ("We usually deem the federal and state equal protection clauses to be identical in scope, import, and purpose. We therefore apply the same analysis in considering state equal protection claims as we do in considering federal equal protection claims under the Fourteenth Amendment to the Federal Constitution."); *Krull v. Thermogas Co.*, 522 N.W.2d 607, 614 (Iowa 1994) ("In equal protection challenges based on the federal and Iowa Constitutions, we usually interpret both federal and state equal protection provisions the same."); *Rudolph v. Iowa Methodist Medical Ctr.*, 293 N.W.2d 550, 557 (Iowa 1980) ("We apply the same test under the federal and state constitutions."). Indeed, in the very rare circumstances under which the Iowa Supreme

Court has construed the state Equal Protection Clause differently from its federal counterpart, the Court took explicit steps to explain clearly its unusual departure from federal precedent. *See Bierkamp v. Rogers*, 293 N.W.2d 577 (Iowa 1980). The Court took no explicit steps that suggest a departure from federal precedent.

CONSTITUTIONAL AND STATUTORY PROVISIONS

United States Constitution, amend. XIV, § 1.

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Iowa Constitution, art. I, § 6.

All laws of a general nature shall have a uniform operation; the General Assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens.

Iowa Code § 99F.11(1).

A tax is imposed on the adjusted gross receipts received annually from gambling games authorized by the chapter at a rate of five percent on the first one million

dollars of adjusted gross receipts, at a rate of ten percent on the next two million dollars of adjusted gross receipts, and at a rate of twenty percent on any amount of adjusted gross receipts over three million dollars. However, beginning January 1, 1997, the rate on any amount of adjusted gross receipts over three million dollars from gambling games at racetracks is twenty-two percent and shall increase by two percent each succeeding calendar year until the rate is thirty-six percent. The taxes imposed by this section shall be paid by the licensee to the treasurer of the state within ten days after the close of the day when the wagers were made and shall be distributed as follows. . . .

STATEMENT OF THE CASE

In this action three racetracks and an association of dog owners challenge the constitutionality of a state tax statute which taxes the revenue from slot machines at racetracks at different rates than the revenue from casino games on riverboats. From 1989 until 1994 casino games, including slot machines, were authorized only on riverboats along the Missouri River and Mississippi River. From the outset, riverboats paid a wagering tax on adjusted gross revenue of five percent on the first million dollars, 10 percent on the next two million dollars and 20 percent on any amount over three million dollars.[1] *See* 1989 Iowa Acts, ch. 67, § 11.

[1] Adjusted gross revenue is the gross receipts less the amount paid out to gamblers. Iowa Code § 99F.1(1) (2001). The Iowa Racing and

(Continued on following page)

In 1994 the Iowa Legislature expanded gambling by authorizing slot machines at racetracks. The racetracks and the riverboats paid the same wagering tax on adjusted gross revenue up to three million dollars. But the Iowa Legislature phased in an escalating tax on adjusted gross revenue in excess of three million dollars from slot machines at racetracks. Beginning in 1997 the tax increased to 22 percent and increased by two percent each succeeding calendar year until the tax reached a top rate of 36 percent. Iowa Code § 99F.11(1) (2001).

Because the escalating tax rate applied to revenue from slot machines at racetracks but not to revenue from casino games on riverboats, a coalition of racetracks and dog owners claimed the tax structure violates the Equal Protection Clauses of the state and federal constitutions. The Respondents are subject to the escalating tax rate on adjusted gross revenues at racetracks or have an interest in racetrack purses that are affected by the escalating tax rates. The Racing Association of Central Iowa operates the racetrack for horses, Prairie Meadows Racetrack and Casino, in Altoona, Iowa. (Cert. Pet. App. 48-49). Dubuque Racing Association, Ltd., and Iowa West Racing Association operate racetracks for dogs in Dubuque and Council Bluffs, respectively. (J.A. 9, 13-14). The Iowa Greyhound Association is an organization of greyhound owners who race animals at the Dubuque and the Council Bluffs

Gaming Commission determines the amount paid out to gamblers. Iowa Code § 99F.4(15) (2001). By rule, the Commission has set a range from 80 percent to 100 percent of the amount wagered. 491 Iowa Admin. Code 11.9(2). The exact amount of the payout is determined by standard methods of probability theory.

racetracks. (J.A. 23-24). In order to put this litigation in context, it is necessary to review the history of the racetracks and the riverboats in Iowa in light of the legislative efforts to rescue these industries from financial difficulties.

A. Wagering at Horse and Dog Tracks

Racetracks and riverboats are distinct businesses authorized under separate statutory frameworks for different purposes. In 1983 Iowa opened the door to gambling by permitting wagering at horse and dog tracks. 1983 Iowa Acts, ch. 187. At that time, betting on horse and dog races was the only gambling permitted at racetracks. (J.A. 24, 26, 28).

By 1989, four racetracks were operating in Iowa: Prairie Meadows, a horse track, in Altoona; Dubuque Greyhound Park, a dog track, in Dubuque; Bluffs Run, a dog track, in Council Bluffs.; and Waterloo Greyhound Park, a dog track, in Waterloo. From 1990 to 1993, all three dog tracks suffered a decrease in annual revenue of more than 50 percent ranging from a low 57 percent decrease at Waterloo to a high 89 percent decrease at Dubuque. (J.A. 37-38). Prairie Meadows, the only horse track in Iowa, experienced similar declines in revenue shortly after it opened in 1989. By 1991 Prairie Meadows filed for chapter 11 bankruptcy. (J.A. 29). Two years later, in 1993, the Waterloo Greyhound Park also filed for chapter 11 bankruptcy. (J.A. 31).

B. Casino Gambling on Riverboats

In 1989, six years after permitting wagering at racetracks, Iowa authorized casino gambling on riverboats. (J.A. 28). To attract economic development to river towns by drawing on Iowa's riverboat heritage, the Iowa Legislature allowed riverboats to offer traditional forms of casino-style gambling in addition to slot machines, including craps, roulette, blackjack, red dog, baccarat, poker and keno. (J.A. 25). The riverboats have been the catalyst for needed economic development in river communities along the historic Mississippi River and the Missouri River which form the eastern and western borders of Iowa.

By 1994, the riverboats also faced economic difficulties. The Iowa riverboats competed for patrons with riverboats licensed in other States. But Iowa imposed strict wager limits of $5.00 per bet and loss limits of $200.00 per person on each riverboat "excursion" which other States did not impose. Iowa Code § 99F.9(2) (1993). In less than one year, Iowa lost three of six riverboats to states with more favorable gambling laws. From July, 1992, to March, 1993, the Diamond Lady, the Emerald Lady and the Dubuque Casino Belle ceased operations in Iowa and transferred into other gaming jurisdictions. (J.A. 30-31, 52, 74).

C. Legislative Reaction to Economically Troubled Industries

In 1994, prompted by the recommendations of a Gaming Task Force appointed by the Governor the previous year to study the two troubled gaming industries, the Iowa Legislature took steps to deal with the distinct economic problems facing racetracks and riverboats. First,

the Legislature eliminated the wager and loss limits on riverboats making them more competitive with neighboring States. 1994 Iowa Acts, ch. 1021, §§ 13, 19. Second, the Legislature authorized slot machines at racetracks as an additional source of revenue. Iowa Code § 99F.4A (2001). At the same time the Legislature adopted a tax rate applicable to adjusted gross revenue from slot machines at racetracks that started at 20 percent for revenue in excess of three million dollars, the same rate applicable to revenue from casino games on riverboats, but escalated the rate applicable to racetracks by two percent each succeeding calendar year until the tax rate reached 36 percent in 2004. 1994 Iowa Acts, ch. 1021, § 25. All three statutes were enacted in one bill; however, the escalating tax rate applicable to racetracks is the only statute challenged in this case.

D. Financial Bonanza for Racetracks

The addition of slot machines at the racetracks dramatically increased the revenue at each racetrack facility. By 1999 slot machines were producing approximately 5 billion dollars in annual revenue at Prairie Meadows, Bluffs Run and Dubuque Greyhound Park. (Rec. State's Exhibit 8, p. 2).

At the time summary judgment motions in this case were submitted to the Iowa district court, the racetrack at Prairie Meadows estimated annual adjusted gross revenues of nearly $150,000,000 from slot machines. The tax rate of 36 percent would have left Prairie Meadows with approximately $100,000,000. (J.A. 120-122). Despite the escalating tax rate, the money left after taxes was sufficient for Prairie Meadows to plan capital improvements

between 1998 through 2006 and to increase purses for horse owners through 2002. (J.A. 113-116).

Slot machines similarly brought increased revenues to Bluffs Run. The dog track projected annual adjusted gross receipts of nearly $123,000,000 from slot machines. (J.A. 141). Application of the 36 percent tax rate would have left a pool of money amounting to approximately $80,000,000. (J.A. 141).

Dubuque Greyhound Park and Casino also showed increased revenue from slot machines. Although the Dubuque racetrack claimed it may be forced to close, it did not attribute this possibility solely to the escalating tax rate. The racetrack cited market maturity and losses in greyhound operations as factors. (J.A. 134). In any event, the Dubuque Racing Association holds the licenses to operate *both* Dubuque Greyhound Park and Casino and the Greater Dubuque Riverboat Entertainment Company. (J.A. 129, 131). A decision to close the racetrack would avoid the escalating tax rate and very likely redirect slot machine patrons from the racetrack to the riverboat – operated by the same nonprofit corporation.

E. Proceedings in the Iowa Courts

The district court dismissed this action in its entirety on December 4, 2000, pursuant to the State's motion for summary judgment. (Cert. Pet. App. 40). The district court identified three conceivable rational bases for the differential tax rates: the legislature wanted to promote development of river communities; the legislature wanted to promote Iowa's riverboat heritage; and the legislature

deemed riverboat casinos to be a useful industry. (Cert. Pet. App. 34).

The Iowa Supreme Court, in a narrow 4-3 decision, reversed the district court and declared the tax rates unconstitutional under the Equal Protection Clause. (Cert. Pet. App. 15-16). The Iowa Supreme Court decided that the sole purpose behind the three statutes enacted in 1994 was "to save the tracks from economic distress" and that a tax structure which distinguishes between revenue from slot machines at racetracks and revenue from casino games on riverboats is irrational.

The three dissenting justices recognized a number of rational bases for taxing the revenue from casino games on riverboats at a lower tax rate:

> Riverboats are not the same as racetracks. From an entertainment perspective, they speak to different cultural traditions – river lore versus agriculture ... [T]here is no constitutional impediment to a legislature favoring diversity in cultural attractions for its citizens and tourists. And, rightly or wrongly, a legislative majority could rationally determine that a riverboat casino holds more romantic tourist appeal than a casino stuck in a dog track.
>
> To advance these policy decisions, a reasonable legislature would also want to recognize a very pragmatic distinction between the two gambling venues: riverboats are mobile, racetracks are not. If the economic climate turns unfavorable here, a riverboat merely unties its lines and sails elsewhere. So it is not unreasonable for the legislature to create economic incentives to develop or retain riverboat gambling while maintaining the status quo with respect to other forms of the sport.

(Cert. Pet. App. 18-19).

F. Impact of the Iowa Supreme Court Decision

The Iowa Supreme Court held the escalating tax rate on adjusted gross revenue from slot machines at racetracks to be unconstitutional as a violation of the Equal Protection Clause and thereby reduced the tax rate applicable to revenue from slot machines at racetracks to a maximum of 20 percent on any amount over three million dollars – a rate exactly equal to the tax rate applicable to adjusted gross revenue from casino games on riverboats.

A constitutional mandate that the State tax the revenue from slot machines at racetracks and from casino games on riverboats at an equal rate could spark a flood of litigation over state and federal tax statutes. Any legislative policy that has been implemented through a tax preference could be vulnerable to attack.

If the Iowa Supreme Court decision stands, Iowa may be forced to refund to the racetracks all taxes on adjusted gross revenue from slot machines collected in excess of 20 percent dating back to 1997. This amount totals more than 100 million dollars. (J.A. 122, 136, 141).

SUMMARY OF ARGUMENT

Rational speculation under the Equal Protection Clause of the Fourteenth Amendment should neither unduly restrict elected state officials who must craft solutions to the tough economic problems that face state

governments nor unreasonably burden the court systems that must consider challenges under the Equal Protection Clause. The Equal Protection Clause allows state legislatures to draw distinctions in tax classifications that, in absence of jeopardy to fundamental rights or creation of categories based on inherently suspect characteristics, need only further a legitimate state interest. Legislatures may make factual assumptions and base tax classifications upon them. These factual assumptions and the relationship of the tax classifications to a legitimate state interest should be upheld unless wholly irrational.

Under this framework, the Iowa Legislature should have been able to relieve the economic problems of the gambling industry without violating the Equal Protection Clause. Two financially troubled businesses – riverboats and racetracks – needed help. In 1994 the Iowa Legislature enacted statutes to assist each business in a different way. To help the riverboats, the Legislature dropped the strict wager and loss limits to make the riverboats more competitive with those licensed in other States. To help the racetracks, the Iowa Legislature took a bold step to authorize racetracks to operate slot machines, a step which no other State had taken at that point in time. Whether the Iowa Legislature could tax this new source of revenue at racetracks at different rates than the revenue from casino games on riverboats should have turned on rational speculation by the Iowa Supreme Court. That is, could the Iowa Legislature prefer riverboats under *any reasonable conceivable set of facts*?

But the Iowa Supreme Court took a detour on the road to rational speculation. The Court rejected legitimate state interests that support a preference for riverboats in drawing tax classifications. The district court had posited

three reasons for the tax classifications that would have met constitutional standards: promoting development of river communities; or promoting riverboat history; or promoting riverboat casinos as a useful industry. (Cert. Pet. App. 34). A tax preference for riverboats might also be supported by a legitimate state interest in preventing riverboats from leaving Iowa; or compensating riverboats for high operating expenses; or protecting the expectations of existing riverboat owners; or attracting new riverboats. By rejecting the legitimate state interests identified by the district court and declining to engage in "rational speculation" to search for any legitimate state interest on its own initiative, the Iowa Supreme Court fell short of its analytic obligation.

In lieu of rational speculation, the Iowa Supreme Court pursued a fact finding mission and substituted its own judgment for that of the Iowa Legislature. The Court erroneously relied on financial data to assess the impact of the escalating tax rates on the racetracks. Concluding that the escalating tax rates "will seriously jeopardize the racetracks' viability," the Court issued the remarkable directive that the Legislature must "tax racetracks and riverboats equally at a rate they both can bear." (Cert. Pet. App. 14).

In this startling application of the Equal Protection Clause, the Iowa Supreme Court substituted its own judgment for the legislative policy decision to structure tax rates to prefer riverboats over racetracks. The Iowa Supreme Court decision marks a profound change in the analytic framework applicable to tax challenges that radically alters the relationship between elected officials and the court system. This decision would limit the legislative prerogative to solve economic problems by substituting fact

finding missions for rational speculation. Tax policy choices would move into courtrooms and overwhelm the already overburdened state and federal court systems with misguided searches for facts sufficient to justify tax classifications under the Equal Protection Clause. Unless balance is restored in this case, an intrusive review of legislative tax policy could dramatically shift the power to solve economic problems away from elected officials and into the courtroom.

The Iowa Supreme Court's construction of the Equal Protection Clause is unsupported by legal precedent and is an unwise intrusion into legislative tax policy that should be reversed.

ARGUMENT

THE STATE OF IOWA DOES NOT VIOLATE THE EQUAL PROTECTION CLAUSE BY TAXING REVENUE FROM SLOT MACHINES AT RACETRACKS AT DIFFERENT RATES THAN IT TAXES REVENUE FROM ALL CASINO GAMES (INCLUDING SLOT MACHINES) ON RIVERBOATS.

Setting the tax rate for adjusted gross revenue from gambling games, the Iowa Legislature distinguished between two classes of taxpayers: riverboat licenses and racetrack licensees. The analytic framework for applying the Equal Protection Clause to these classifications of taxpayers is neither novel nor complex. The United States Constitution prohibits the States from denying "to any person within its jurisdiction the equal protection of the laws." U.S. Const. amend. XIV, § 1. This language "does not forbid classifications. It simply keeps government

decisionmakers from treating differently persons who are in all relevant respects alike." *Nordlinger v. Hahn*, 505 U.S. 1, 10 (1992). A statute must be upheld if there is any reasonable conceivable factual basis to support it. *FCC v. Beach Communications, Inc.*, 508 U.S. 307, 313 (1993).

Generally, the Equal Protection Clause requires only a "plausible policy reason for the classification, [that] the legislative facts on which the classification is apparently based rationally may have been considered to be true by the governmental decisionmaker, and [that] the relationship of the classification to its goal is not so attenuated as to render the distinction arbitrary or irrational." *Nordlinger v. Hahn*, 505 U.S. at 11 (citations omitted).

These standards have been applied to tax classifications with particular deference. As early as 1890 this Court declared the Fourteenth Amendment "was not intended to compel the states to an iron rule of equal taxation." *Bell's Gap R. Co. v. Commonwealth*, 134 U.S. 232, 235 (1890). *See also Magoun v. Illinois Trust & Savs. Bank*, 170 U.S. 283, 294 (1898) ("There is therefore no precise application of reasonableness of classification, and the rule of equality permits many practical inequalities.") Nearly forty years later, this Court declared that "inequalities which result from a singling out of one particular class for taxation or exemption infringe no constitutional limitations." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 509 (1937). "[I]n taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Madden v. Kentucky*, 309 U.S. 83, 88 (1940). More recent cases have defined a narrow role of judicial review for legislative choices in taxation. *Lehnhausen v. Lake Shore Auto Parts*, 410 U.S. 356, 359-61 (1973). The power to tax is a sovereign power reserved

to the States which ensures the States' fiscal systems and economic vitality. *Id.* at 357 (citing to *Allied Stores v. Bowers*, 358 U.S. 522, 526-27 (1959)).

Application of the correct analytic framework to the tax classifications in this case should have sustained the constitutionality of the state statute.

A. Differences in Tax Rates Imposed by States Are Subject to Rational Basis Review and Must be Upheld if Supported by Any Conceivable Rational Basis for the Tax Structure.

The Iowa Supreme Court failed to accord the Iowa Legislature the appropriate deference in formulating the tax classifications. State "legislatures are presumed to have acted within their constitutional power despite the fact that, in practice, their laws result in some inequality." *Nordlinger v. Hahn*, 505 U.S. at 10 (quoting from *McGowan v. Maryland*, 366 U.S. 420, 425-46 (1961)). When establishing classifications for taxation, "the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Williams v. Vermont*, 472 U.S. 14, 22 (1985) (quoting from *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. at 359)). *See also Regan v. Taxation with Representation of Wash.*, 461 U.S. 540, 547 (1983).

The analytic framework for the equal protection analysis did not require the Iowa Supreme Court to evaluate the merits of the legislative policy underlying the tax classifications. Indeed, such an evaluation exceeds the Court's authority. A court considering whether rational bases support a statute is not compelled to verify the legislative decision with statistical evidence. *Hughes v.*

Alexandria Scrap Corp., 426 U.S. 794, 812 (1976). A Court may find a rational basis for an enactment even when the facts relative to that basis are disputed or their "effect opposed by argument and opinion of serious strength." *Rast v. Van Deman & Lewis Comp.*, 240 U.S. 342, 357 (1916). Due to the strong presumption of validity that attaches to legislative tax determinations, the Constitution gives great latitude to legislative factual and policy judgments. *See FCC v. Beach Communications, Inc.*, 508 U.S. at 307, 313-14, 320 ("[T]he assumptions underlying [the legislature's] rationales may be erroneous, but the very fact that they are arguable is sufficient, on rational-basis review, to immunize the congressional choice from constitutional challenge"). "[U]nless a classification warrants some form of heightened review because it jeopardizes exercise of a fundamental right or categorizes on the basis of an inherently suspect characteristic, the Equal Protection Clause requires only that the classification rationally further a legitimate state interest." *Nordlinger v. Hahn*, 505 U.S. at 10.

The Iowa Supreme Court failed to apply rational basis review to the differential tax structure at issue in this case. Rather than engage in rational speculation about legitimate state interests that could support tax classifications that express a preference for riverboats, the Iowa Supreme Court scrutinized the legislative decision itself. The Court assessed the worsening financial condition of the racetracks before the arrival of slot machines. Next, the Court assessed impact of the escalating tax rates on the new slot machine revenue from the racetracks. Then, second-guessing the legislative decision to authorize slot machines at financially distressed racetracks yet impose a higher tax rate on racetracks than on riverboats, the Court

concluded the tax classifications were irrational. (Cert. Pet. App. 13-14, 16).

The Court took up consideration of state interests in support of the tax classifications only after concluding that the tax classifications were irrational. Viewed in this analytic sequence, it is unsurprising that the Court rejected all of the state interests that were urged in support of the tax classifications. (Cert. Pet. App. 14-15). Addressing the legislative tax preference for riverboats, the Court said flatly: "we are not persuaded that our state riverboat history can only be promoted through such favoritism as taxing racetracks at an eighty percent higher rate than riverboats. The State can make riverboats more competitive with other states without penalizing racetracks through a thirty-six percent tax on gross receipts." (Cert. Pet. App. 15). Ultimately, the Court mandated absolute equality in taxation. (Cert. Pet. App. 17). This judicial oversight of legislative policy is squarely at odds with rational speculation.

If the Equal Protection Clause is applied to facilitate judicial intrusion into the legislative process, decision making on tax policy will shift away from state legislatures into the courtrooms. Unless rational speculation is applied by courts to search for "plausible policy reasons" for tax classifications, judicial intrusion could threaten tax classifications designed to carry out social policy. Tax credits, for example, are often offered by States to further social policies, including, economic development, employment and expansion of state facilities. "Today every state provides tax incentives as an inducement to local industrial location and expansion." Hellerstein, *Commerce Clause Restraints on State Tax Incentives*, 82 Minn. L. Rev. 413, 431 (1997). State and federal tax incentives have been

enacted to promote growth and development in distressed areas. *See, e.g.*, 42 U.S.C. § 11501 (authorizing Enterprise Zone Development); 42 U.S.C. § 5308 (authorizing community development through loan guarantees), 42 U.S.C. § 198 (Brownfields tax incentives to promote environmental clean-up). To the extent that these tax statutes extend tax credits to persons in distressed areas, but not to persons engaged in similar activities in non-distressed areas, the Iowa Supreme Court decision threatens to unravel the tax differentials.

A return to rational speculation would accord legislatures the appropriate leeway to draw tax classifications which in their judgment produce reasonable systems of taxation.

B. Racetracks and Riverboats Are Not Similarly Situated Businesses.

Under rational speculation, the equal protection analysis should have ended at the threshold question whether the state statute treats differently classes of taxpayers who are "in all relevant respects alike." *Nordlinger v. Hahn*, 505 U.S. at 10. If the taxpayers are not similarly situated, a difference in treatment cannot violate the Equal Protection Clause. *See Parham v. Hughes*, 441 U.S. 347, 354-56 (1979). Because the tax applies to revenue from slot machines both at racetracks and on riverboats, the Iowa Supreme Court concluded the two businesses are "alike in all relevant respects." (Cert. App. 7-9).

The Court's perspective focuses on the ultimate source of revenue rather than the taxpayers. Courts should focus on whether the taxpayers are similarly situated, not

whether the taxpayers pay taxes on similar sources of revenue. *See, e.g., General Motors Corp. v. Tracy*, 519 U.S. 278, 285, 311-12 (1997) (natural gas purchasers taxed differently based on source of supply); *Nordlinger v. Hahn*, 505 U.S. at 16-17 (property owners taxed differently based on recency of real estate transactions); *Kadrmas v. Dickinson Pub. Schs.*, 487 U.S. 450, 463-65 (1988) (parents taxed differently for transportation of school children based on status of school district).

Beyond obvious cultural, recreational and economic differences,[2] the facilities are authorized to conduct different forms of gaming. Riverboats may be licensed to conduct "gambling games." Iowa Code § 99F.7(1) (2001). The Iowa Racing and Gaming Commission has the authority to decide which gambling games are permitted on the riverboat casinos. Iowa Code §§ 99F.1(9), 99F.7(1) (2001). The Commission, in turn, has promulgated rules approving craps, roulette, blackjack, red dog, baccarat, poker, slot machines, and video poker. 491 Iowa Admin. Code 11.5. Racetracks, by contrast, are limited to slot machines. Iowa Code § 99F.1(9) (2001). (J.A. 24-25). Even if riverboats have opted to use most of their casino space for slot machines, (Cert. Pet. App. 8), the scope of authorized gaming is fundamentally broader and gaming could shift from slot

[2] The two businesses serve very different purposes. Racetracks promote the agricultural economy by assisting the horse and dog industries; riverboats promote economic development by drawing the tourist industry to old river cities along Iowa's borders. Justice Neuman, in her dissent from the Iowa Supreme Court's majority opinion, aptly described this difference: "[f]rom an entertainment perspective, they speak to different cultural traditions – river lore versus agriculture." (Cert. Pet. App. 18).

machines to other casino games at the discretion of the riverboat owners with the approval of the Commission.

A proper focus on the nature of the businesses should have led the Iowa Supreme Court to conclude that the two classes of taxpayers are not similarly situated.

C. Iowa's Escalating Tax Rates on Revenue From Slot Machines at Racetracks Rationally Further Numerous Legitimate State Interests.

The Iowa Supreme Court overlooked numerous legitimate state interests which support the tax classifications. Certainly, the Equal Protection Clause "does not demand for the purpose of rational-basis review that a legislature or governing decisionmaker actually articulate at any time the purpose or rationale supporting its classification." *Nordlinger v. Hahn*, 505 U.S. at 15. *See United States R.R. Retirement Bd. v. Fritz*, 449 U.S. 166, 179 (1980); *Allied Stores v. Bowers*, 358 U.S. 522, 528 (1959). Rather, a classification "must be upheld against equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *FCC v. Beach Communications, Inc.*, 508 U.S. at 313.

The state interest underlying a tax classification is rarely codified into law. When the state interest is codified, consideration by the courts of "any reasonably conceivable state of facts" may be cut short. In *Allegheny Pittsburgh Coal Co. v. County Comm'n*, 488 U.S. 336 (1989), for example, the West Virginia Constitution expressly required all real property to be "taxed at a rate uniform throughout the State according to its estimated market value." *Id.* at 345. The state interest in tax assessments

had been expressly written into the constitution and, therefore, any classifications in relation to assessments had to be consistent with this articulated purpose. When the county assessor valued taxable property based solely on its recent purchase price, property recently sold was necessarily taxed at a much higher rate than property that had not been sold in decades. Because this practice created "gross disparities in the assessed value of generally comparable property," *id.* at 338, the classifications of taxpayers created by the assessor's practices could not be held to rationally further the state interest expressly spelled out in the state constitution. *Id.* at 338, 344-45.

The statute in issue in this case does not indicate the purpose for which the Iowa Legislature drew the challenged tax classifications. In the absence of such codification of the purpose of a law, courts may look to state interests for a law articulated by legal counsel defending the classification or to state interests for the law found by lower courts, or may itself identify another possible state interest that would justify the law. *Kadrmas v. Dickinson Pub. Schs.*, 487 U.S. 450, 463 (1988) ("[W]e are not bound by explanations of the statute's rationality that may be offered by litigants or other courts. Rather, those challenging the legislative judgment must convince us 'that the legislative facts . . . could not reasonably be conceived to be true by the governmental decisionmaker.'") (quoting from *Vance v. Bradley*, 440 U.S. 93, 111 (1979)). No empirical support is necessary to sustain such a classification. *Vance v. Bradley*, 440 U.S. at 110.

Consistent with a strong presumption of constitutionality and the judicial deference due tax classifications, this Court has invalidated state tax laws in rare circumstances when statutes confer tax benefits on a wholly arbitrary

basis, *see, e.g., Williams v. Vermont*, 472 U.S. 14, 23-24 (1985), or the tax classifications do not further any legitimate state interest, *see, e.g., Hooper v. Bernalillo*, 472 U.S. 612, 618-22 (1985). But it is clear that a State may use tax policy to foster a particular type of business. "Where the public interest is served one business may be left untaxed and another taxed, in order to promote the one . . . or to restrict or suppress the other. . . ." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. at 512.

The Iowa Supreme Court should have considered all of the "plausible policy reasons" relied upon by the Iowa district court and should have engaged in rational speculation on its own to search for any conceivable rational basis for the tax classification which imposed a lower tax rate on gaming revenue from riverboats than from racetracks.

The Iowa district court used rational speculation to find three legitimate state interests for taxing the gaming revenue from riverboats at a lower rate than the gaming revenue from racetracks:

- *Promoting development of river communities.*
- *Promoting riverboat history.*
- *Promoting riverboat casinos as a useful industry.* (Cert. Petition App. 34).

The Iowa Legislature could have looked to any of these interests to impose a lower tax rate on gaming revenue from riverboats, and thereby limit "the burden of the tax in order to foster what it conceives to be a beneficent enterprise." *See Carmichael v. Southern Coal & Coke Co.*, 301 U.S. at 512. As determined by the district court, the Iowa Legislature could have seen the riverboats industry as more important to the State than racetracks, thus

justifying a more favorable tax rate. Or the legislature may have seen the economic development of riverfronts on Iowa's rivertowns as more important than providing a windfall to the racetracks. *See City of Fort Madison, Iowa v. Emerald Lady*, 990 F.2d 1086, 1087 (8th Cir. 1993) ("Several years ago, in a bid to attract tourists and stimulate local economies, Iowa legalized riverboat gambling."). Or the legislature may have seen the promotion of historic riverboats as a greater tool than racetracks for economic development, tourism, or marketing. Any of these reasons is sufficient to satisfy the equal protection test. *See FCC v. Beach Communications, Inc.*, 508 U.S. at 317. Drawing tax classifications is clearly a legislative judgment. As Justice Neuman stated in her dissent: "[R]ightly or wrongly, a legislative majority could rationally determine that a riverboat casino holds more romantic tourist appeal than a casino stuck in a dog track." (Cert. Pet. App. 18).

Additional conceivable rational bases supporting the classifications created by the Iowa Legislature could include the following:

• *Preventing more riverboats from leaving Iowa*. The legislature could have reasonably retained the 20 percent maximum tax rate on adjusted gross revenue from casinos games on riverboats in order to prevent more riverboats from leaving the State. By 1994 the promising early experiment with riverboat gambling was quickly turning into a failure. Three of the original six riverboat casinos left Iowa to operate in other states with more favorable gambling laws. (J.A. 30, 52, 74). By maintaining the 20 percent maximum tax rate on adjusted gross revenue from slot machines on riverboats, Iowa remained competitive with the tax rates in other states that allowed riverboat

gambling. *See* Ill. Rev. Stat. Ch. 120, ¶ 2413 (1991) (20 percent rate); Mo. Rev. Stat. § 313.822 (1993) (20 percent rate).

• *Compensating riverboats for high operating expenses*. The legislature may have reasonably assumed that the tax on adjusted gross revenue from gambling games on riverboats should be limited to 20 percent, because the riverboats have operating expenses that land-based operations do not. Unlike other States, Iowa does not allow riverboats to remain permanently docked to land. Iowa's riverboats must satisfy yearly "cruising" requirements established by the Iowa Racing and Gaming Commission. Iowa Code § 99F.7(1) (2001); 491 IAC 5.6(2). Further, riverboats in Iowa are required to be designed to replicate the design of riverboats from Iowa history. Iowa Code § 99F.7(3) (2001). The riverboats are also subject to an additional layer of extensive regulations due to the operation on navigable water regulated by the federal government. (*See* City of Bettendorf Amicus Brief in Support of Petition for Writ of Certiorari, p. 8, n. 2).

• *Protecting the expectations of existing riverboat owners*. The legislature may have rationally assumed a need to protect the vested expectations of the businesses who had established riverboats in Iowa. The riverboats established prior to 1994 faced a top tax rate of 20 percent on adjusted gross revenue in excess of three million dollars. The vested expectation of taxpayers is a legitimate state interest when drawing tax classifications. *Nordlinger v. Hahn*, 505 U.S. at 12-13 (considering the vested expectations of existing landowners); *United States R.R. Retirement Bd. v. Fritz*, 449 U.S. at 178 (considering the expectations of long-time pensioners). Protecting vested expectations may be particularly important when setting

tax rates for a business that is mobile and can feasibly relocate to another jurisdiction.

• *Attracting new riverboats to Iowa*. The legislature may have rationally assumed a lower tax rate could draw new riverboats to Iowa. New riverboats encourage development of local industries that service the riverboats, i.e., barges, hull inspection services, marine supplies and repair, and dock construction and improvement. The increased tourist traffic, in turn, encourages development of hotels and restaurants. In addition, the riverboats themselves provide a market for Iowa products, because the riverboats must sell arts, crafts, and gifts that are native to and made in Iowa. Iowa Code § 99F.7(5) (2001).

Had the Iowa Supreme Court properly considered "plausible policy reasons" for the tax classifications, analysis of the rational relationship between the tax classifications and the legislative goal would have become evident. Surely a lower tax rate on gaming revenue from riverboats furthers a legitimate state interest in promoting development of river communities; or promoting riverboat history; or promoting riverboat casinos as a useful industry; or any of the legitimate state interests set forth above. (Cert. Pet. App. 34).

D. The Iowa Supreme Court Misconstrued the Equal Protection Doctrine and Improperly Substituted Its Own Policy Judgment for That of the Iowa Legislature.

Rejecting the district court's "plausible policy reasons" for the tax classifications and declining to engage itself in "rational speculation," a narrow majority of the Iowa

Supreme Court shifted focus to the legislative purpose underlying a separate statute not in issue in this case. (Cert. Pet. App. 4). Addressing the legislative purpose for authorizing slot machines at the racetracks, the Court observed:

> Overriding this entire issue is the fact that the 1994 legislation was designed to save the racetracks and riverboats from financial distress. . . . The primary reason the legislature authorized racetracks to operate slots was to provide them with increased revenue. Without revenue from the slot machines, the Racetracks' future was in question.

(Cert. Pet. App. 10-11). Once the Court headed down this path, the escalating tax rate appeared to be at odds with the legislative purpose of saving the racetracks from financial distress. (Cert. Pet. App. 11). How, the Court wondered, could a tax classification that weighs more heavily on the racetracks further the State's interest in saving the racetracks from economic distress? (Cert. Pet. App. 13-14).

1. The 1994 Legislation Served Multiple Purposes.

Because the Iowa Supreme Court improperly treated the three separate and distinct statutes enacted in 1994 as a single enactment with a single purpose, the Court ignored several legitimate state interests that support the tax classifications in issue. Although the legislature did authorize slot machines "to save the racetracks," the legislation authorizing slot machines at racetracks is not the legislation challenged in this case. Section 99F.4A, enacted in 1994, allowed the racetracks to make application

for gambling licenses. Iowa Code § 99F.4A (2001) ("Upon application, the commission shall license the licensee of a pari-mutuel dog or horse racetrack to operate gambling games at a pari-mutuel racetrack enclosure. . . ."). The legislative purpose of this statute is distinct from the legislative purposes in creating two tax classifications for the adjusted gross revenue from slot machines at racetracks and on riverboats.

Legislators may have a number of different reasons for enacting a statute, and it is not possible for the Courts to "record a complete catalogue of the considerations that move [legislative] members to [act]." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. at 510. Because a legislature need not articulate reasons for enacting a statute, *United States R.R. Retirement Bd. v. Fritz*, 449 U.S. at 179, the absence of legislative facts explaining the distinction between classifications "on the record" has no significance in a rational basis case. *FCC v. Beach Communications, Inc.*, 508 U.S. at 315. A single bill encompassing several different and entirely separate statutory provisions could have "multiple and somewhat inconsistent purposes" that are the product of compromises made by individual legislators during the bill-making process. *United States R.R. Retirement Bd. v. Fritz*, 449 U.S. at 181 (Stevens, J., concurring).

In its effort to ascertain the one "true" legislative intent, the Iowa Supreme Court placed undue significance on the presumed motive of an individual legislator. The Court noted the proposal for an escalating tax on the revenue from slot machines at racetracks originated from a legislator representing a riverboat district. (Cert. Pet. App. 4). It is improper under federal and state law to derive the legislative purpose of a statute from the words

of a single legislator. *See Bread Political Action Committee v. Fed. Election Comm'n*, 455 U.S. 577, 581 n.3 (1982) (no weight accorded to affidavits of a senator); *Donnelly v. City of Des Moines*, 403 N.W.2d 768, 771 (Iowa 1987) ("[W]e will not consider a legislator's own interpretation of the language or purpose of a statute. . . . "); *Ruthven Consol. Sch. Dist. v. Emmetsburg Cmty. Sch. Dist.*, 382 N.W.2d 136, 140 (Iowa 1986) ("In common with most states we will not consider a legislator's private interpretation of a statute, even if the legislator was actively involved in drafting and enacting the legislation."). Because statutes are enacted by a legislature acting as a whole, the motive of an individual legislator is not imputed to the legislative body.

2. The Iowa Supreme Court Improperly Used Fact Finding Instead of Rational Speculation.

Deviating from the rational basis test, the Iowa Supreme Court improperly engaged in its own fact finding in an effort to *disprove* any rational relationship between the differential tax rates and the single purpose the Court posited for enactment of the statute. In doing so, the Court ignored alternative purposes the Iowa Legislature might have had as a basis for the differential tax rate and any reasonable beliefs the Iowa Legislature might have had as a basis on which it predicated the differential tax rates. Because of the strong presumption of validity attached to a tax statute, a reviewing court may not through its own independent fact finding substitute its view of the relevant facts for any factual basis reasonably assumed to exist by the legislature.

The Court relied on the amount of revenue generated by slot machines from racetracks in proportion to revenue

generated from other sources and the amount of tax that the racetracks are expected to pay in future years as a limitation on the amount of charitable distributions. (Cert. Pet. App. 8-13). These fact findings are used by the Court to buoy a flawed conclusion: the state's only legitimate purpose in enacting the tax statute was to save the racetracks from financial distress, and the escalating tax on gaming revenue from racetracks "is contrary to" and "frustrates" this legislative purpose.[3] (Cert Pet. App. 11, 13).

[3] The Iowa Supreme Court's factual observations were not only improper but simply incorrect. The scant evidence in the record on this issue is sufficient to show that the two major tracks are thriving – and would continue to thrive under a 36 percent tax on adjusted gross revenue. When motions for summary judgment were submitted to the district court, Prairie Meadows estimated annual adjusted gross receipts of $149,453,670 for future years. At the highest tax rate of 36 percent, the tax would be $53,093,321. (J.A. 122). Prairie Meadows would then retain $96,360,321 for operating expenses and public purpose expenditures which include subsidizing horse racing, contributing to county government and making other charitable contributions. Similarly, the figures at Bluffs Run show adjusted gross receipts of $123,000,000 and taxes at 36 percent of $48,170,000 which leaves a pool of $74,830,000 in money for operating expenses and public purpose expenditures. (J.A. 136). The racetracks have sufficient funds under the applicable tax rates to expend significant amounts at the track facilities and to attract interested buyers. Prairie Meadows planned to spend money for improvements – $6 million from 1998 to 2002 and $14 million from 2003 through 2006, even though the tax rate would have peaked in 2004. Spending $20 million for improvements at the facility, with no need to borrow, is the sign of a thriving enterprise. Further, Prairie Meadows planned to increase purses to horse owners from $10,312,251 in 1998 to $16,595,606 in 2002, even as the racetrack approached the top tax rate. (J.A. 114). Meanwhile, Bluffs Run was sold in 1999 to Harveys', a sophisticated company well familiar with the gaming business and fully aware that the tax rate would progress in the future to 36 percent. (J.A. 145).

This Court has summarily reversed a state supreme court for such a factual foray into the record. In *Central State Univ. v. American Ass'n of University Professors*, 526 U.S. 124 (1999) (per curiam), the Ohio Supreme Court, like the Iowa Supreme Court in this case, had erroneously looked to evidence in the record to determine whether a statute was supported by a rational basis. *Id.* at 126-127. This Court held the fact that there is a lack of evidence in the record to establish a rational basis "does not detract from the rationality of legislative decision." *Id.* at 128.

A court should not decide whether facts assumed by the legislature were accurate on the basis of independent judicial determinations but rather only whether facts assumed by the legislature were wholly irrational or unreasonable. When considering the constitutionality of a tax statute, courts should consider all conceivable rational purposes and the reasonableness, not the correctness, of any factual assumptions that the legislature may have made when it enacted the statute. If independent judicial determinations were allowed to substitute for rational basis review, equal protection challenges would turn into fact finding missions. Issues that should be decided on the basis of motions would become fact-based litigation with discovery and full-blown trials.[4]

[4] Already, one Iowa district court has applied the decision to reject a motion to dismiss a challenge to the State's local option sales tax statute under the Equal Protection Clause. The ruling appears to be based on the notion that the challenge should be measured by evidence rather than rational speculation. *See Coalition for a Common Cents Solution v. State*, No. EQCV26737 (Iowa) (October 8, 2002) ("[T]he statute does not set out the legislative basis for the local option sales tax. It would be pure speculation on the part of this Court to make such

(Continued on following page)

3. The Iowa Supreme Court Improperly Questioned the Fairness of the Tax Rates.

The Iowa Supreme Court's decision appears to question the fundamental fairness of the escalating tax rate on racetracks. Statements that the wagering tax "disabl[es] an industry it was allegedly designed to aid" and may "drive the racetracks out of business" demonstrate the Court's disagreement with the legislature's tax policy. (Cert Pet. App. 15). The Iowa Supreme Court falls short of labeling the tax rates a violation of substantive Due Process and for good reason – this Court has been rejecting Due Process claims in tax cases for more than 130 years.

Except in "rare and special instances," the Due Process Clause is not a limitation upon the taxing power conferred upon Congress or a state legislature. *Magnano Co. v. Hamilton*, 292 U.S. 40, 44 (1934). The appropriate level or rate of taxation is essentially a matter for legislative resolution. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 627 (1981). The wisdom or fairness of a tax is not subject to the control or revision of the courts. *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 444 (1944).

This Court has "consistently refused either to undertake the task of passing on the reasonableness of a tax that otherwise is within the power of Congress or of state legislative authorities, or to hold that a tax is constitutional because it renders a business unprofitable." *City of*

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a determination at this stage in the proceedings."). (Cert. Pet. App. 75-76).

Pittsburgh v. Alco Parking Corp., 417 U.S. 369, 373 (1974). Even a tax that has the impact of "destroying a particular occupation or business" will be upheld under the Due Process Clause if the legislature had the power to enact it. *Id.* at 374; *Magnano Co. v. Hamilton*, 292 U.S. 40, 44 (1934); *Alaska Fish Salting & By-Products Co. v. Smith*, 255 U.S. 44, 48 (1921). As stated by this Court nearly a century ago:

> [The petitioner's] reasoning has no application to a lawful tax, for if it had there would be an end of all taxation; that is to say, if a lawful tax can be defeated because the power which is manifested by its imposition may, when further exercised, be destructive, it would follow that every lawful tax would become unlawful, and therefore no taxation whatever could be levied. ...

Knowlton v. Moore, 178 U.S. 41, 60 (1900).

Taxpayers have unsuccessfully sought relief from tax rates they deem oppressive. *See, e.g., Veazie Bank v. Fenno*, 75 U.S. 533, 548-49 (1869) (upholding a ten percent tax on notes paid by state banks); *McCray v. United States*, 195 U.S. 27, 28, 64 (1904) (upholding a 10 cents tax on colored oleomargarine, notwithstanding a 1/4 cent tax on uncolored oleomargarine); *Alaska Fish Salting & By-Products Co. v. Smith*, 255 U.S. at 47-49 (upholding a license tax of two dollars a barrel upon persons manufacturing fish oil, fertilizer and meal from herring, but not salmon); *Magnano Co. v. Hamilton*, 292 U.S. at 41, 47 (upholding an excise tax of 15 cents on butter substitutes, but not butter); *City of Pittsburgh v. Alco Parking Corp.*, 417 U.S. at 378-79 (upholding a 20 percent tax on the gross receipts from private parking garages, with no similar tax for public parking garages). The only judicial

query is whether the legislature can lawfully levy the tax. *Stewart Dry Goods Co. v. Lewis*, 294 U.S. 550, 563 (1935). In *Stewart Dry Goods*, the Court soundly advised potential litigants considering a challenge to a tax statute:

> He deludes himself by a false hope who supposes that, if this court shall at some future time conclude the burden of the exaction has become inordinately oppressive, it can interdict the tax.

Id. at 563.

CONCLUSION

For the foregoing reasons, the judgment of the Iowa Supreme Court should be reversed.

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